

FUTURE PRICING OF SPECTRUM USED FOR TERRESTRIAL BROADCASTING

RESPONSE TO THE OFCOM CONSULTATION FROM CHRYSALIS RADIO

1. Chrysalis Radio is one of the UK's three major commercial radio broadcasters. We own and operate nine analogue local radio stations under the Heart, Galaxy and LBC brands. In addition, Chrysalis is the lead shareholder in the MXR regional DAB multiplex consortium, and broadcasts its services – including the digital-only station, The Arrow – on a range of regional and local multiplexes, including those operated by MXR. Chrysalis is a member of the RadioCentre and supports the submission being made by the RadioCentre on this consultation.

2. In making this response to the Ofcom consultation, we are under no illusions that Ofcom has not already made its final decision with regard to spectrum pricing. From the tone of the consultation, it is clear that, even if opposition to spectrum pricing were universal, Ofcom has no intention of changing its decision. We question the value, to both Ofcom and stakeholders, of going through the motions of a consultation that has no prospect of influencing Ofcom's decision-making.

Spectrum pricing

3. It is readily apparent from Ofcom's own analysis that the logic of applying Administered Incentive Pricing (AIP) is fatally flawed. It is based on premises that, whilst they may be rational from a theoretical economic standpoint, cannot be achieved in reality. Ofcom appears to be wedded to an economic principle that may not be appropriate in all circumstances and, in our view, is not appropriate to apply to broadcasting as it fails to take into economic account the loss of social value. Moreover, calculating the social value is almost impossible in practice.

4. A fundamental principle behind AIP is that "if the opportunity costs of spectrum use are ignored or discounted, socially sub-optimal decisions will be made." Ofcom has equated economically optimal outcomes – realising the opportunity cost of spectrum use – with socially optimal ones. This appears to be on the basis that 'society' experiences the cost of inefficient spectrum use. However, we believe not all of the social benefit has been taken into account. Indeed, there are a range of social benefits from a radio service being broadcast, not only in the content broadcast, but in the range of services available in any geographic area. Such social benefits would appear to be contrary to economic optimal outcomes, which associates with such broadcast services the opportunity cost of that spectrum being used by a broadcaster, and not by a telecoms company, who may pay a much higher premium for the use of that spectrum. These social benefits are contrary to the social benefit mentioned in the consultation document, by way of a premium, AIP paid to the Treasury. It is clear that the social benefits of broadcast services have not been accurately considered or valued.

5. The principle that AIP avoids sub-optimal decisions is self-evidently only true where the spectrum user is able, physically and legally, to make decisions about its spectrum use. This is not true with broadcasting, and no amount of economic sleight of hand makes it true. Commercial broadcasters have no control over the allocation and clearing of frequencies or transmitter sites, the extent of licensed coverage areas, or

almost any other aspect relating to the efficiency of spectrum use. Unless and until we are granted such control, through more general spectrum liberalisation, AIP has no role to play in our decision-making on spectrum use, sub-optimal or otherwise. Broadcasters are not currently able to acknowledge the opportunity cost of their spectrum use, or make decisions to reduce that opportunity cost, irrespective of the 'incentives' applied to encourage it. You might just as well incentivise us to fly, and then impose a charge for each foot we have left on the ground. Penalising broadcasters for failing to do the impossible strikes us as logically nonsensical.

6. Ofcom states that "one of the best ways of ensuring that the opportunity costs of spectrum are fully and accurately reflected by decision makers, is for those opportunity costs to be reflected in prices that have to be paid to hold spectrum." There is repeated reference to ensuring that "opportunity costs are fully and accurately reflected in decisions made about spectrum use." In the context of broadcasting, the "decision makers" are Ofcom. Yet it is not Ofcom that will feel the effect of the opportunity cost, or whose decisions on spectrum use will be affected by AIP.

7. In paragraph 3.21, Ofcom suggests some types of decisions that broadcasters are likely to make that do, in fact, impact on their spectrum use decisions. These relate, primarily, to the adoption or otherwise of certain types of new technology. However, Ofcom again equates spectrum efficiency with social gain when it describes such decisions as only being "in the best interests of citizens and consumers" if they are "taken with a full appreciation of the opportunity cost of spectrum." Moreover, Ofcom seems to ignore the fact that operators of DAB multiplexes are already economically incentivised to maximise the efficient use of the spectrum they occupy. All multiplex operators derive their revenue from the 'letting' of the capacity on the multiplexes. The only way to maximise that revenue is by ensuring that all the available capacity is in use. The opportunity cost of inefficient use is felt by the multiplex operator as a direct financial cost. AIP would add nothing to the incentive for efficient spectrum use, and would therefore merely represent an additional, and unnecessary, cost to multiplex operators.

8. Ofcom adds, unhelpfully, that broadcasters are "free to press for a relaxation of the technical and other constraints on their use of spectrum – or ... a refocusing of the constraints they operate under." Pressing Ofcom for things is very different to securing them. It is clearly specious for Ofcom to argue that we might lobby for additional control over our spectrum use when any such grant of control is entirely in Ofcom's gift. Either Ofcom wishes us to have such control or it doesn't, but that surely is the first decision to make, before imposing a pricing regime based on the false premise that we have such control. It is notable that Ofcom refers to the Future of Radio Licensing project as one that will be affected by AIP. It is wrong for Ofcom to state that this project will be "able" to consider and respond to the AIP proposals. In fact, it will have no choice but to respond to them, and by pre-empting this project, AIP could limit the range of options available in addressing the future of radio licensing. By making a decision about AIP before carefully assessing the economic value of broadcasting in the FoRL project, Ofcom is fettering its own discretion across a whole range of future policy reviews of vital importance to broadcasters. Applying economic theory to broadcasting must surely require it to be fully and rigorously applied.

9. Acknowledging that broadcasters presently have no control over their spectrum use, Ofcom argues that "the use of AIP is none the less, in our view, justified by the benefits that should materialise in the longer term, as better decisions are made." This

only makes sense if Ofcom plans, in the long term, to give broadcasters more control over their use of spectrum. Any such plans would surely require further detailed consideration and consultation, as well as primary legislation. We believe it is inappropriate and premature to pre-empt those processes by deciding now to introduce AIP.

10. We note that, in paragraph 2.9, the success of AIP is measured by the amount of spectrum surrendered to Ofcom by non-broadcast spectrum users. We find it difficult to reconcile Ofcom's apparent desire to see broadcasters relinquish spectrum with its statutory duties to ensure for the public a wide range of quality broadcast services. Ofcom adds, in paragraph 3.11, that: "It is important to understand in this context that the application of AIP is not designed to achieve any particular change in spectrum use in either the short or long term, other than the general objective of securing optimal use." Perhaps Ofcom could explain, in the context of DAB, for example, what it considers to be optimal use, and how the socially optimal goals of providing radio services for citizens are to be reconciled with the economically optimal goals of minimising our use of spectrum. It appears to us that AIP could actually create a strong disincentive to make socially optimal decisions on spectrum use. The decision to seek an extension to the PPA of a local multiplex into an otherwise unserved area, for example, would clearly be socially beneficial by extending the range of radio services to the people living in that area. However, multiplex operators are likely to be deterred from making such a decision if one consequence were that they were penalised by additional AIP costs.

11. We note, from paragraph 2.13 of the consultation, that terrestrial DAB will, even after the additional allocations agreed in RRC06, account for just under 2% of the spectrum under 1GHz. Even if AIP were capable of achieving efficiency gains in DAB spectrum use, it is clear that they would, in the grand scheme of things, be trivial.

12. Ofcom is asking us to comment on a proposal without giving any indication as to the actual impact of the proposal, or any means for us to calculate or predict the impact. Ofcom quotes a figure of £650,000 as the projected opportunity cost of using a single frequency block to provide nationwide coverage on DAB. However, no clue is given as to how this figure has been reached. Moreover, Ofcom acknowledges that its estimates are subject to a "high degree of uncertainty." Indeed, no hint is given even as to the basis on which each broadcaster's AIP costs will be calculated. In particular there's no evidence that the social and political benefits of radio provision have been given economic value.

13. Ofcom acknowledges broadcasters' arguments that "some broadcasting does generate a value for society in excess of the value to the individual broadcaster" but dismisses the logical impact this should have on AIP. The fact is not only that broadcasting is a public good, delivered for public benefit, but that it is Parliament's wish, expressed through a succession of statutes, that Ofcom should ensure a wide range of high quality services on television and radio. We are unclear as to how the imposition of AIP is consistent with this objective. Ofcom adds that other public services, such as emergency services and even mobile telephony, also deliver public value but are charged AIP. To us, this is an argument for reducing their AIP, not imposing it on broadcasters. Additionally, we do not know to what extent those other spectrum users have control over the efficiency of their spectrum use. Where spectrum users have such control, we accept that AIP has a role to play in incentivising more efficient use of spectrum. Such an argument might readily be applied to the BBC, for example, which

has almost total control over the use of the spectrum blocks allocated to it which, we believe, it uses inefficiently. The same is not true of commercial radio.

14. The separation that Ofcom makes between the allocation of spectrum and the social benefit derived from its use is an artificial distinction in the context of spectrum allocated solely and specifically for that social benefit. The way that broadcasting licensing works means that the two are inextricably linked.

15. Ofcom's economic analysis leads it to conclude that it would be preferable to provide a direct cash subsidy for public service broadcasting rather than subsidise spectrum use. This strikes us as absurd. It would lead to the worst possible outcome for all stakeholders. The opportunity cost of spectrum use would still exist, it would merely be offset by the payment of AIP fees from which the Treasury is the sole beneficiary. The Treasury then pays out cash back to broadcasters to subsidise the production of programming that they were already making. This would seem to be a much less efficient mechanism to ensure content of public value. The outcome of the present system – namely the provision of high quality public service broadcasting without any unnecessary movement of cash around the system – is surely more efficient and more desirable by being less bureaucratic, less complex and of proven success.

16. We accept the point made in paragraph 3.33 that discounting spectrum does not, in theory, lead automatically to the delivery of socially desirable programming. However, the reality is that, under the current system of discounted spectrum, the UK has benefitted from more than 80 years of high quality public service broadcasting, from both the BBC and, more recently, commercial broadcasters. The public has been well served by the present arrangements.

17. We fail to see the logic of the arguments presented in paragraph 3.34 that “discounting the price of one input [i.e. spectrum] will almost certainly lead to inefficient decisions being made about the use of other inputs.” This conclusion does not appear to be based on hard evidence. Radio has existed without AIP for more than 80 years – and commercial radio for more than 30 – and we are unaware of any evidence that we make inefficient decisions on the use of other inputs as a result. Specifically, we see no rationale for the claim that “if only spectrum is discounted, a broadcaster is likely to use more spectrum than would be efficient, and invest too little in other inputs to achieve the desired level of output.” Can Ofcom provide any examples of other inputs in which it believes we have invested too little, and in which more would have been invested had we been subject to AIP? If we are using more spectrum than is efficient, this is surely because of decisions made by the regulator in allocating and assigning that spectrum. It seems illogical to penalise broadcasters for decisions made by the regulator.

18. Ofcom estimates that the cost of AIP would represent less than 2% of the PSB programming budget for BBC TV or Channel 4, but more (no indication is given as to how much more) for radio. This is based on Ofcom's current assessment of the financial impact of AIP, whose basis is not stated and whose reliability is suspect given Ofcom's own admission that its calculations are subject to considerable uncertainty. Even if we accept Ofcom's calculations at face value, it is clear that radio will be paying greater than 2% of its programming budget to achieve, in theory rather than in practice, greater efficiency in the use of less than 2% of the spectrum under 1GHz. Given the potential harm that could be done to radio broadcasters, and the possible reduction in the

provision of a range of high quality services to citizens and consumers, the cost of AIP would appear to outweigh the gains.

19. Ofcom's statement that delaying the introduction of AIP until 2012 provides "ample opportunity for alternative policy instruments to be put in place to secure the continued fulfilment of public policy objectives for broadcasting after its introduction" merely highlights the extent to which Ofcom has put the cart before the horse. It is surely more sensible to establish the policy principles first, and then devise the mechanisms to achieve them. The premature introduction of that mechanism limits the range of policy instruments available to achieve the public policy objectives. AIP surely needs to be shown to be consistent with the policy objectives, not the other way around.